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USDA FAS FOR OCRA (FLEMINGS, KUYPERS) AND ONA (SALLYARDS,
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COMMERCE FOR MAC (MATT EDWARDS, JACK BROUGHER)
STATE PLS PASS USTR (BETSY HAFNER)

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TAGS: ETRD EAGR EINV ECON RS

SUBJECT: BITTER HARVEST: JOHN DEERE ON RUSSIAN TRADE CASE
AGAINST HARVESTERS

Classified By: Economic Minister Counselor Eric T. Schultz, Reasons 1.4
(b,d).

¶1. (C) SUMMARY: Deere & Company Russia Country Director Sidney Bardwell told us August 5 that Deere believes the Ministry of Economic Development (MED) and the Ministry of Industry and Trade (MIT) have conducted a fair investigation, but will likely determine that domestic producers have been injured by increasing imports of harvesters. The company believes there is a disagreement within the GOR about the investigation. The Ministry of Agriculture is concerned that the imposition of tariffs or quotas on imported harvesters could harm Russia's agriculture sector. The Ministry of Industry and Trade, on the other hand, favors an import quota to help domestic harvester producers, regardless of the economic cost and impact on food prices. Bardwell said the GOR will likely impose some sort of remedy to protect the domestic industry. Deere is hoping that the GOR will opt for a modest increase in duties and stop short of an import quota. He said Deere also believes foreign producers will continue to be pressured to set up tractor and harvester production operations in Russia. END SUMMARY.

SAFEGUARDS ACTION AGAINST GRAIN HARVESTERS

¶2. (C) On August 5, Deere & Co. Russia Country Director Sidney Bardwell provided ECON, USDA and FCS officers an overview of the ongoing safeguards investigation of combine harvesters that the GOR initiated on February 15, 2008. Combine harvesters are used to harvest major grains and certain vegetables, including wheat, corn, barley, oats, beans, peas, oil seeds and millet. Bardwell noted that the three major importers to Russia (U.S. producers Deere and Case New Holland, and German producer Claas), had all entered the case as interested parties, as had U.S., EU and German trade associations representing agriculture equipment manufacturers.

¶3. (C) At a hearing on June 26, Russian combine harvester producers made the same basic arguments they had aired when the Ministry of Economic Development launched the investigation in February. Imports increased by over seven percent from 2004 to 2006, and rose by 80 percent during the first half of 2007 compared to the first half of 2006, causing domestic producers' sales and market share to decline. Looking at full year 2007 data, the rise in imports

had not been as dramatic as during the first half of 2007, according to Bardwell, though he believed imports had been rising year-on-year by an average of about 16 percent from 2004 to 2007. (There are no publicly available statistics on the level of harvester imports and domestic sales in Russia.)

¶4. (C) At the hearing, Baldwell said importers and foreign producers disagreed that rising imports had injured the domestic industry. They argued that the Russian market for combine harvesters was bifurcated. Domestic producers held the lion's share of sales of small harvesters of less than 250 horsepower. No Russian company produced large harvesters of 250 horsepower or greater, and that segment of the market was supplied by the major foreign producers. Far from having been harmed by imports, domestic producers had actually been able to introduce annual price hikes of three to five percent and still controlled over 70 percent of the overall market.

¶5. (C) Bardwell said that in response to foreign producers' arguments about a bifurcated market, domestic producers countered that they should also be given an opportunity to develop a domestic industry producing larger and more efficient harvesters over 250 horsepower. That was the future growth area of the market, but the dominant position of imports prevented domestic producers from entering that segment.

¶6. (C) According to Bardwell, overall demand for both domestic and imported harvesters was growing well beyond the supply capacity of domestic and foreign producers. He noted that Deere was operating at or near maximum production capacity worldwide and now had a one-year waiting list in

Russia on harvester orders. He believes that at a minimum, the Russian agricultural sector needs 8,000 additional harvesters per year, but Russia could absorb up to 15,000 units per year if all of the arable land in Russia was farmed. Bardwell predicted there would be almost 3,000 new harvesters imported into Russia in 2008, plus an additional 1,000 imports of used and resold harvesters. The domestic producers would be challenged to produce as many as 7,500 harvesters per year.

¶7. (C) Bardwell noted that the Ministry of Economic Development and Ministry of Industry and Trade (which inherited the case after the May 2008 government reorganization) appeared to have been conducting a fair investigation. Both domestic and foreign parties had been afforded the opportunity to file opening briefs, participate at the hearing, and to file post-hearing supplemental briefs. Deere's only procedural complaint was that the Ministry of Industry and Trade (MIT) had not yet distributed to the parties a sanitized version of the domestic industry's 600-page opening brief.

INTERNAL GOR DISAGREEMENT OVER INVESTIGATION
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¶8. (C) Bardwell said Deere and other foreign producers believe, based on information from government sources, that there is a disagreement within the GOR about the wisdom of the safeguards investigation. The Ministry of Agriculture recognizes that the imposition of an import quota or high tariff could hamper the development and modernization of Russian agriculture.

¶9. (C) Bardwell said Industry and Trade Minister Khristenko, however, favors an import quota of 1,500 harvesters per year, regardless of the short to medium term effect on the agriculture sector and the potential impact on food prices that would result from a sharp drop in imports. This would allow domestic producers the opportunity to develop the capacity to produce larger and more efficient harvesters above 250 horsepower.

¶10. (C) To save face, Bardwell said the GOR will likely impose some sort of remedy, but he is hoping that it will be

only a modest tariff increase, rather than the imposition of a steep duty or an import quota.

PRESSURE ON FOREIGN FIRMS TO ESTABLISH DOMESTIC PRODUCTION

¶11. (C) Bardwell also believes the investigation was launched to pressure Deere and other major foreign producers to set up tractor and harvester production operations in Russia.

During Deere CEO Robert Lane's most recent trip to Russia, Agriculture Minister Gordeyev had urged the company to set up tractor and harvester production in Russia.

¶12. (C) Bardwell said Deere took the offer seriously and had performed a thorough economic analysis, but had informed Gordeyev that the company could not set up such a venture in the absence of tax incentives or lower tariffs on agriculture equipment components. These measures would be necessary to make such a venture economically feasible. Since the exchange with Gordeyev, Deere had also "been told" by the Orenburg and Kaluzhskaya Oblast governors that they should set up tractor and harvester production in Russia.

DEERE'S LONG-TERM PLANS IN RUSSIA

¶13. (C) Bardwell said that despite the ongoing safeguards investigation, Deere remains bullish on Russia as one of the company's major growth markets over the next several years. Among the BRIC countries, Deere's overall agricultural equipment sales in Russia in 2008 are expected to surpass sales to Brazil (the BRIC sales leader in 2007), making Russia the company's second biggest market after the United

States. Sales in India and China are far lower than in Brazil and Russia, even though Deere has a major production facility in Kunming, China.

¶14. (C) Bardwell said Deere's facility in Orenburg assembles seeding equipment that contains 35 percent local content. The company hopes to increase the amount of local content in that equipment over the next few years, as Russian suppliers become more skilled at supplying finished agricultural components and finished steel shapes. The company also plans to expand the Orenburg operation to include assembly of tilling equipment. The proposed \$70 million facility in Kaluzhskaya Oblast would make agricultural components, weld and paint tractor frames, and also serve as a company logistics and training center.

¶15. (C) COMMENT: The investigation will likely conclude by mid-November, though it is possible MIT could choose to extend the investigation for another three months until February 2009. If MIT finds that the domestic industry has been injured by imports, the GOR would then have up to 14 days to decide on a remedy, such as increased tariffs or an import quota. We share Bardwell's hope that cooler heads within the GOR will prevail, and in the worst case scenario, persuade the GOR to impose a modest tariff rather than a steep duty or import quota. We will continue to closely monitor the case in consultation with Deere, cognizant of the USG's rights under our 1992 bilateral trade agreement to request consultations with the GOR over this case.

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